



Financial Management Report

AS OF MARCH 31, 2007

AT A GLANCE:

General Fund revenues ahead of last year by 3.7 percent.

Puget Sound 2006 area job growth largest in 8 years

Washington State predicts continued job growth in local area

Global economic conditions expected to create positive growth in local area

Local economist cautions that historical trends may point toward recession in two to three years (see page 7)

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Summary of All Operating Funds: *Revenue*

- General Fund** revenue is budgeted to increase 5.5 percent in 2007 over 2006, largely from expectations of higher sales and utility tax revenue and property tax dedicated to public safety staffing. Actual revenues are trailing, at 3.7 percent ahead of the same period last year, largely due a dip in sales tax and building permit revenues and despite strong utility tax revenue and plan check development fees. An unusual spike in February sales tax revenue in 2006 skews the year-to-date comparison. Total General Fund revenues are expected to track at or above budget as the year progresses.
- Other General Government Funds** revenues are budgeted 9.4 percent higher in 2007 than last year largely due to increased internal charges and the move of Multi-media Services from the General Fund to the Information Technology Fund. Actual collections are tracking higher than planned, at 12.9 percent ahead of the same period last year, mostly due to the receipt of 2006 cable tax revenue in 2007.
- Water Sewer Operating Fund** revenue is budgeted 4.3 percent higher in 2007 than 2006 due to water and sewer rate increases and normal growth. Actual revenue is tracking just above expected, at 5.2 percent, which is within a normal range of revenue collection for this utility.
- Surface Water Management Fund** revenue collection is budgeted 4.9 percent higher in 2007 than 2006 due to rate increases and normal growth. Actual revenue is 11.6 percent ahead of the same period last year. There is a lag in timing when a rate increase is adopted, which was the case in 2006, skewing the comparison between the years since 2007 revenue reflects collection of the rate increase for the full year. Surface Water fees are paid through property tax collection, which are primarily received in April and October. This causes the relatively small collection rate as of March 31st.
- Solid Waste Fund** revenue collection is budgeted to increase 5.6 percent in 2007 over 2006 due to higher rates and normal growth. Actual revenue is 2.3 percent behind the same period last year due to variability in collections for this utility. Revenue is expected to track at budget as the year progresses.

Resources by Fund	Year-to-Date Actual			Budget			% of Budget	
	3/31/2006	3/31/2007	% Change	2006	2007	% Change	2006	2007
General Gov't Operating:								
General Fund	9,926,350	10,292,726	3.7%	49,091,816	51,809,969	5.5%	20.2%	19.9%
Other General Gov't Operating Funds	2,695,268	3,044,199	12.9%	15,170,554	16,590,146	9.4%	17.8%	18.3%
Total General Gov't Operating	12,621,618	13,336,925	5.7%	64,262,370	68,400,115	6.4%	19.6%	19.5%
Utilities:								
Water/Sewer Operating Fund	3,487,695	3,669,418	5.2%	15,802,180	16,474,571	4.3%	22.1%	22.3%
Surface Water Management Fund	210,499	234,850	11.6%	4,977,108	5,222,394	4.9%	4.2%	4.5%
Solid Waste Fund	1,972,141	1,925,842	-2.3%	7,449,930	7,864,908	5.6%	26.5%	24.5%
Total Utilities	5,670,335	5,830,110	2.8%	28,229,218	29,561,873	4.7%	20.1%	19.7%
Total All Operating Funds	18,291,953	19,167,035	4.8%	92,491,588	97,961,988	5.9%	19.8%	19.6%

* Budgeted and actual revenues exclude resources forward and include interfund transfers.



Volatility in Other Operating Funds expenditures often occurs from the timing of major equipment purchases, such as the Kirkland fire engine pictured above

Summary of All Operating Funds: *Expenditures*

- General Fund** expenditures are budgeted to increase 5.3 percent in 2007 over 2006 largely due to increased personnel costs and additional staffing. Actual expenditures are 12.2 percent ahead of the same period last year primarily due to the settlement of a labor contract from 2006 in 2007.
- Other Operating Funds** expenditures are budgeted to increase 15.3 percent over 2006 primarily due to increased personnel, operating and fuel costs, and the shift of Multi-media Services from the General Fund. Actual expenditures are 7 percent behind the same period last year due to several large vehicle purchases made in the first quarter of 2006 (such as a fire engine and dump trucks) and despite the settlement of a labor contract from 2006 in 2007.
- Water/Sewer Operating Fund** expenditures are budgeted to increase 9.3 percent in 2007 over 2006 due to higher water purchases and sewer treatment costs and increased regional connection charges paid to Cascade Water Alliance (covered by connection charge revenue). Actual expenditures are slightly higher, at 10 percent ahead of the same period in 2006, primarily due to the settlement of a labor contract from 2006 in 2007.
- Surface Water Management Fund** expenditures are budgeted to increase 14.8 percent in 2007 over 2006 largely due to increased funding for capital projects and additional plans generated from the completed Surface Water Master Plan, and increased personnel costs. Actual expenditures are tracking higher, 20.2 percent ahead of the same period in 2006 due to the settlement of a labor contract from 2006 in 2007, as well as relatively significant staffing vacancies in the first part of 2006.
- Solid Waste Fund** expenditures are budgeted to increase 8 percent in 2007 over 2006 due to higher solid waste contract rates. Actual 2007 expenditures are slightly behind at 4.4 percent over the same period in 2006 due to normal variability in disposal contract payment timing.

Expenditures by Fund	Year-to-Date Actual			Budget			% of Budget	
	3/31/2006	3/31/2007	% Change	2006	2007	% Change	2006	2007
General Gov't Operating:								
General Fund	11,359,810	12,750,856	12.2%	49,962,235	53,460,486	7.0%	22.7%	23.9%
Other General Gov't Operating Funds	4,037,710	3,753,650	-7.0%	15,072,831	17,384,421	15.3%	26.8%	21.6%
Total General Gov't Operating	15,397,520	16,504,506	7.2%	65,035,066	70,844,907	8.9%	23.7%	23.3%
Utilities:								
Water/Sewer Operating Fund	3,876,429	4,265,210	10.0%	15,492,943	16,932,266	9.3%	25.0%	25.2%
Surface Water Management Fund	430,810	518,006	20.2%	4,939,600	5,672,207	14.8%	8.7%	9.1%
Solid Waste Fund	1,819,378	1,900,195	4.4%	7,247,024	7,828,067	8.0%	25.1%	24.3%
Total Utilities	6,126,617	6,683,411	9.1%	27,679,567	30,432,540	9.9%	22.1%	22.0%
Total All Operating Funds	21,524,137	23,187,917	7.7%	92,714,633	101,277,447	9.2%	23.2%	22.9%

* Budgeted and actual expenditures exclude working capital, operating reserves, capital reserves, and include interfund transfers.

General Fund Revenue

Many revenues are subject to seasonal variability and timing of large receipts can also skew year-to-year comparisons

- **Sales tax** revenue collection is budgeted to increase 7.3 percent ahead of 2006 due to expected strong development-related activity. Actual receipts are 3 percent behind the same period last year due to an unusual one-time spike in receipts received in February 2006. Revenue is expected to rebound to or above the budgeted amount as the year progresses. A more detailed analysis of sales tax revenue can be found starting on page 5.
- **Utility tax** revenue is budgeted to increase 10.9 percent ahead of 2006 primarily due to higher utility rates. Actual revenue collection is up 13.7 percent ahead of the same period last year primarily due to natural gas and electricity (higher rates and weather conditions) and also strong telephone utility tax receipts.
- **Business licenses and franchise fees** are budgeted to increase 19.8 percent over 2006 primarily due to franchise fees. Actual revenue shows no growth so far this year due to timing of business license renewals. The **revenue generating regulatory license** fee is budgeted to increase

8.3 percent over 2006. Actual revenue is down 4 percent compared to the same period last year, also due to timing of business license renewals.

- **Development-related fees** revenues are a mixed bag. **Building/structural permits** are budgeted 4.7 higher than 2006, but actual revenue is 15.3 percent lower than the same period in 2006. **Plan check/development fees** are budgeted 19.8 percent lower than 2006, but actual revenue is 16.1 percent higher compared to 2006. **Engineering development charges** are budgeted 56.3 percent higher than 2006 and actual revenues are trailing 2006, down 16.1 percent compared to the same period. The trends for development-related revenue this year reflect the volatility that is inherent in development activity.
- **Fines/forfeits** revenue was expected to remain flat, budgeted 0.4 percent lower than 2006. Actual revenue is up 39.4 percent compared to the same period in 2006 as a result of the timing of traffic cases as well as higher than expected revenue from the new false alarm program.

General Fund revenues as of March 31 are over \$350,000 ahead of the same period in 2006.

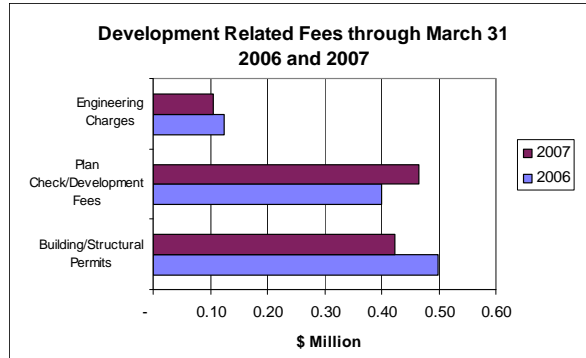
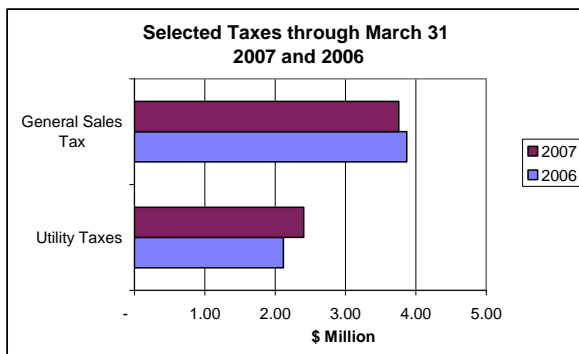
General Fund revenue is budgeted to increase 5.5 percent over 2006. Actual revenue is trailing just slightly, up 3.7 percent over the same period last year largely due to sales tax anomalies discussed above.

The General Fund is the largest of the General Government Operating funds. It is primarily tax supported and accounts for basic services such as public safety, parks and recreation, and community development.

About 355 of the City's 447 employees are budgeted within this fund.

General Fund Resource Category	Year-to-Date Actual			Budget			% of Budget	
	3/31/2006	3/31/2007	% Change	2006	2007	% Change	2006	2007
Taxes:								
Retail Sales Tax: General	3,871,420	3,755,081	-3.0%	14,132,692	15,158,006	7.3%	27.4%	24.8%
Retail Sales Tax: Criminal Justice	259,888	280,977	8.1%	890,000	1,025,000	15.2%	29.2%	27.4%
Property Tax	365,996	385,463	5.3%	8,117,113	8,790,086	8.3%	4.5%	4.4%
Utility Taxes	2,115,356	2,405,025	13.7%	7,171,200	7,950,034	10.9%	29.5%	30.3%
Rev Generating Regulatory License	276,804	265,644	-4.0%	900,000	975,000	8.3%	30.8%	27.2%
Other Taxes	136,506	105,221	-22.9%	464,800	461,000	-0.8%	29.4%	22.8%
Total Taxes	7,025,970	7,197,411	2.4%	31,675,805	34,359,126	8.5%	22.2%	20.9%
Licenses & Permits:								
Building, Structural & Equipment Permits	498,944	422,598	-15.3%	2,084,742	2,183,450	4.7%	23.9%	19.4%
Business Licenses/Franchise Fees	363,130	363,170	0.0%	1,184,775	1,418,950	19.8%	30.6%	25.6%
Other Licenses & Permits	35,454	32,458	-8.5%	169,020	169,900	0.5%	21.0%	19.1%
Total Licenses & Permits	897,528	818,226	-8.8%	3,438,537	3,772,300	9.7%	26.1%	21.7%
Intergovernmental:								
Grants	34,996	88,265	152.2%	207,017	163,795	-20.9%	16.9%	53.9%
State Shared Revenues & Entitlements	132,493	138,871	4.8%	590,033	606,715	2.8%	22.5%	22.9%
Fire District #41	-	-	N/A	3,141,052	3,329,121	N/A	N/A	N/A
EMS	-	-	N/A	489,685	504,376	N/A	N/A	N/A
Other Intergovernmental Services	250,275	166,341	-33.5%	438,539	423,870	-3.3%	57.1%	39.2%
Total Intergovernmental	417,764	393,477	-5.8%	4,866,326	5,027,877	3.3%	8.6%	7.8%
Charges for Services:								
Internal Charges	741,033	840,636	13.4%	3,531,586	3,365,127	-4.7%	21.0%	25.0%
Engineering Services	124,323	104,269	-16.1%	400,000	625,000	56.3%	31.1%	16.7%
Plan Check & Development Fees	400,751	465,417	16.1%	2,276,836	1,825,900	-19.8%	17.6%	25.5%
Recreation	4,470	-	-100.0%	74,000	81,000	9.5%	6.0%	N/A
Other Charges for Services	92,407	187,730	103.2%	674,199	752,591	11.6%	13.7%	24.9%
Total Charges for Services	1,362,984	1,598,052	17.2%	6,956,621	6,649,618	-4.4%	19.6%	24.0%
Fines & Forfeits	149,838	208,873	39.4%	1,157,550	1,152,750	-0.4%	12.9%	18.1%
Miscellaneous	72,266	76,687	6.1%	590,991	405,900	-31.3%	12.2%	18.9%
Total Revenues	9,926,350	10,292,726	3.7%	48,685,830	51,367,571	5.5%	20.4%	20.0%
Other Financing Sources:								
Interfund Transfers	-	-	N/A	405,986	442,398	N/A	N/A	N/A
Total Other Financing Sources	-	-	N/A	405,986	442,398	N/A	N/A	N/A
Total Resources	9,926,350	10,292,726	3.7%	49,091,816	51,809,969	5.5%	20.2%	19.9%

* Budgeted and actual revenues exclude resources forward.



General Fund Expenditures

General Fund Department Expenditures	Year-to-Date Actual			Budget			% of Budget	
	3/31/2006	3/31/2007	% Change	2006	2007	% Change	2006	2007
Non-Departmental	181,513	243,917	34.4%	851,614	1,128,527	32.5%	21.3%	21.6%
City Council	132,108	128,848	-2.5%	311,733	316,392	1.5%	42.4%	40.7%
City Manager's Office	624,588	689,715	10.4%	2,431,813	3,150,421	29.6%	25.7%	21.9%
Human Resources	204,778	242,015	18.2%	855,969	1,036,649	21.1%	23.9%	23.3%
City Attorney's Office	212,337	218,180	2.8%	881,406	957,460	8.6%	24.1%	22.8%
Parks & Community Services	1,057,717	1,153,405	9.0%	5,096,976	5,847,886	14.7%	20.8%	19.7%
Public Works (Engineering)	717,771	918,037	27.9%	2,887,897	3,611,756	25.1%	24.9%	25.4%
Finance and Administration	726,572	827,999	14.0%	2,891,824	3,473,508	20.1%	25.1%	23.8%
Planning & Community Development	730,863	852,065	16.6%	2,965,328	3,706,159	25.0%	24.6%	23.0%
Police	3,047,449	3,245,152	6.5%	12,962,506	13,745,515	6.0%	23.5%	23.6%
Fire & Building	3,599,492	4,106,446	14.1%	14,578,689	15,780,853	8.2%	24.7%	26.0%
Total Expenditures	11,235,188	12,625,779	12.4%	46,715,755	52,755,126	12.9%	24.1%	23.9%
Other Financing Uses:								
Interfund Transfers	124,622	125,077	0.4%	3,246,480	705,360	-78.3%	3.8%	17.7%
Total Other Financing Uses	124,622	125,077	0.4%	3,246,480	705,360	-78.3%	3.8%	17.7%
Total Expenditures & Other Uses	11,359,810	12,750,856	12.7%	49,962,235	53,460,486	-65.3%	22.7%	23.9%

* Budgeted and actual expenditures exclude working capital, operating reserves, and capital reserves.

- The **Non-departmental** division expenditures are budgeted 32.5 percent higher than 2006 due to a relocation of the Multi-media functions to Information Technology resulting in a change in accounting for the internal charges. Actual expenditures are 34.4 percent higher than the same period in 2006.

Budgeted and current year actual expenditures compared to 2006 for the following departments are up primarily due to higher personnel costs, including an unsettled labor contract from 2006 that settled in 2007 and additional positions added in 2007. In addition to this general trend, specific highlights by selected department are listed below:

- The **City Manager's** expenditures are budgeted 29.6 percent higher than 2006 due the addition of a communications coordinator and municipal court staffing, and additional funding for economic development and outside agencies. Actual expenditures are only 10.4 percent ahead of the same period last year primarily due to the normal delay in hiring newly approved positions.
- The **Human Resources Department** expenditures are budgeted 21.1 percent higher than 2006 due to an additional temporary human resources analyst. Actual expenditures are only 18.2 percent ahead

(Continued on page 5)

Compared to budget, 2007 General Fund actual expenditures are tracking at about the same trend as last year (23.9 percent of budget in 2007 compared to 23.6 percent of budget in 2006).

Adjustments in 2007 for an unsettled 2006 labor contract are the primary driver of cost increases between the years.

of the same period last year due to the delay of hiring the new position.

- The **Public Works Department** expenditures are budgeted 25.1 percent higher than 2006 due to additional administrative support and a temporary construction inspector, as well as transportation-related service packages for traffic counts and transportation management plans. Actual expenditures are 27.9 percent higher than the same period in 2006.
- The **Finance & Administration Department** expenditures are budgeted 20.1 percent higher due to additional utility billing staff. Actual expenditures are trailing slightly, only 14.0 percent higher than the same period in 2006 due to the timing of election cost payments.
- The **Planning Department** expenditures are budgeted 25 percent higher than 2006 due to additional development-related staffing. Actual expenditures are only 16.6 percent ahead compared to the same period last year due to the delay in hiring additional staffing.
- The **Fire & Building Department** expenditures are budgeted 8.2 percent higher than 2006 due to additional development staff and a temporary emergency preparedness coordinator. Actual expenditures are 14.1 percent ahead compared to the same period last year primarily due to 2006 staff vacancies and one-time expenditures for computer-aided dispatch software and Emergency Operation Center laptop computers in 2007.



Lake Washington Shoreline
at Juanita Bay Park

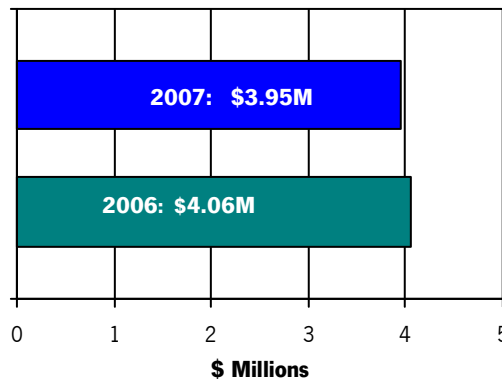
Sales Tax Revenue Analysis

2007 sales tax revenue is down 2.9 percent compared to the same period in 2006 primarily due to a one-time spike in development-related revenue received in February 2006. Overall, sales tax revenue remains strong due to auto/gas retail and even though development-related activity is behind last year, it also is performing well compared to historical levels.

Review by business sectors:

- **Auto/gas retail** is the star performer so far this year, **up 16.7 percent** compared to the same period last year due to strong performance of several key retailers.
- **General merchandise/miscellaneous retail** is **up 6.4 percent** over the same period last year due to strong performance by key retailers.
- **Other retail declined 9.9 percent** over the same period last year due to decreases in electronics/appliances and one-time anomalies in the retail food and retail health care sectors in 2006 that skew comparisons between the years.
- **Retail eating/drinking** is flat, **up only 0.7 percent** compared to the same period last year.
- Business sectors impacted by development-related activity (contracting, wholesale, and services) are down in 2007 compared to the same period last year due more to the phenomenal strength in 2006 rather than weakness in 2007. (**Wholesale is down 35.3 percent, contracting is down 1.3 percent** and **services is down 22.2 percent**.)

Sales Tax Receipts
through March 2006 & 2007



While development-related sales tax revenue is down from last year, it remains strong compared to historical trends.

Auto/gas retail is the star performer so far this year.

Business Sector Group	Jan - Mar		Dollar Change	Percent Change	Percent of Total	
	2006	2007			2006	2007
Services	515,182	401,042	-114,140	-22.2%	12.7%	10.2%
Contracting	759,803	749,689	-10,114	-1.3%	18.7%	19.0%
Communications	140,146	139,841	-305	-0.2%	3.4%	3.5%
Auto/Gas Retail	664,605	775,882	111,277	16.7%	16.4%	19.7%
Gen Merch/Misc Retail	617,898	657,612	39,714	6.4%	15.2%	16.7%
Retail Eating/Drinking	284,062	285,984	1,922	0.7%	7.0%	7.2%
Other Retail	502,642	452,662	-49,980	-9.9%	12.4%	11.5%
Wholesale	391,710	253,625	-138,085	-35.3%	9.6%	6.4%
Miscellaneous	187,873	231,239	43,366	23.1%	4.6%	5.8%
Total	4,063,921	3,947,576	-116,345	-2.9%	100.0%	100.0%

Kirkland's sales tax base is comprised of a variety of businesses which are grouped and analyzed by business sector (according to NAICS, or "North American Industry Classification System"). Nine business sector groupings are used to compare 2006 and 2007 year-to-date sales tax receipts in the table to the left.

When analyzing monthly sales tax receipts, there are two items of special note: First, most businesses remit their sales tax collections to the Washington State Department of Revenue on a monthly basis. Small businesses only have to remit their sales tax collections either quarterly or annually, which can create anomalies when comparing the same month between two years. Second, for those businesses which remit sales tax monthly, there is a two month lag from the time that sales tax is collected to the time it is distributed to the City. For example, sales tax received by the City in March 2007 is for sales actually made in January 2007. Monthly sales tax receipts through March 2006 and 2007 are compared in the table above.

Month	Sales Tax Receipts		Dollar Change	Percent Change
	2006	2007		
January	1,116,572	1,267,021	150,449	13.5%
February	1,821,021	1,525,665	(295,356)	-16.2%
March	1,126,328	1,154,890	28,562	2.5%
Total	4,063,921	3,947,576	150,449	-2.9%

A one-time spike in development-related revenue in February 2006 skews the comparison to 2007 (see table above).

Kirkland's sales tax base is further broken down by business district (according to geographic area), as well as "unassigned or no district" for small businesses and businesses with no physical presence in Kirkland.

Totem Lake, which accounts for over 32 percent of the total sales tax receipts, **is up 9 percent**, primarily due to strong performance in "auto/gas retail" and despite the closure of a major supermarket and electronics store. The impact of the new sporting goods store that opened in April will not be seen until later this year.

NE 85th Street, which accounts for over 14 percent of the total sales tax receipts, **is up 2.3 percent** primarily due to the "retail automotive/gas" sector and despite weak performance in the "general merchandise/miscellaneous retail" sector.

Downtown, which accounts for almost 7 percent of the total sales tax receipts, **is up 1 percent**

reflecting flat performance across virtually all sectors in this business district.

Carillon Point & Yarrow Bay, which accounts for almost 3 percent of the total sales tax receipts, **is down 23.7 percent** reflecting the inherent volatility of software/technology companies performance.

Houghton & Bridle Trails, which accounts for over 3 percent of the total sales tax receipts, **is up 20.7 percent** almost entirely due to "miscellaneous retail".

Juanita, which accounts for almost 2 percent of the total sales tax receipts, **is up 5.3 percent** largely due to the "retail eating/drinking" sector.

When reviewing sales tax receipts by business district, it's important to point out that over 40 percent of the revenue received in 2007 is in the "unassigned or no district" category largely due to strong contracting revenue, but it also reflects increasing revenue from Internet and catalog sales from businesses located outside of the City.

Business District	Jan - Mar Receipts		Dollar Change	Percent Change	Percent of Total	
	2006	2007			2006	2007
Totem Lake	1,168,125	1,273,514	105,389	9.0%	28.7%	32.3%
NE 85th St	554,950	567,930	12,980	2.3%	13.7%	14.4%
Downtown	269,448	272,053	2,605	1.0%	6.6%	6.9%
Carillon Pt & Yarrow Bay	140,341	107,091	-33,250	-23.7%	3.5%	2.7%
Houghton & Bridle Trails	112,099	135,251	23,152	20.7%	2.8%	3.4%
Juanita	67,258	70,806	3,548	5.3%	1.7%	1.8%
Unassigned or No District:						
Contracting	759,848	749,688	-10,160	-1.3%	18.7%	19.0%
Other	991,852	771,243	-220,609	-22.2%	26.0%	21.3%
Total	4,063,921	3,947,576	-116,345	-2.9%	100.0%	100.0%

Sales Tax Revenue Outlook

Although sales tax revenue is down slightly through March 2007 compared to March 2006, it is expected to recover as the year progresses. However, the dependence on one-time revenue from development-related activity is illustrated by the impact on this year's revenue. If these sectors were performing at a more typical growth rate (6 percent), total revenue would be up 6.1 percent over last year instead of down 2.9 percent.

Opportunities for growth exist from the redevelopment of Totem Lake Mall and Park Place, current major expansions at key automobile dealerships, and the hotel that opened last year and one currently under construction downtown. However, the economic recession a few years ago and the current reliance on construction-related sales tax growth serve as reminders that sales tax is an economically sensitive revenue source. In good times, sales tax growth easily outpaces the rate of inflation and is an attractive funding source for service packages. However, when a downturn occurs, the City's financial ability to maintain existing services can be quickly threatened. Additional volatility is created by gaining or losing significant businesses, shifts in construction activity due to economic conditions, and one-time field audit recoveries.

OFFICE VACANCIES:

Eastside vacancy rates remain low at 8.62 percent at the end of the first quarter 2007 compared to 24 percent in 2003 according to CB Richard Ellis Real Estate Services.

LODGING TAX REVENUE:

Lodging tax revenue is up 75 percent compared to the same period last year due to overall strong performance in the accommodations industry as well as the new hotel in Totem Lake.

Economic Environment Update

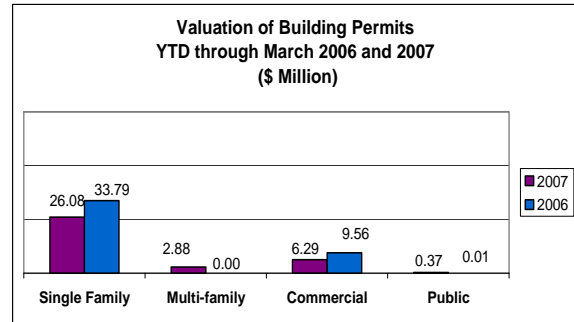
Local job growth remains strong in 2007, especially in the important aerospace and technology sectors. The Seattle-Tacoma metropolitan area added over 65,000 jobs since January 2005 and the unemployment rate in King County dropped to 4.3 percent as of March 2007, slightly below the national average of 4.5 percent. The Hebert Research-Business Journal Business Confidence Index rose to 62.7 for the first quarter of 2007, up from 60.8 in the fourth quarter of 2006. Local executives expressed confidence by overwhelming margins that the economy is likely to improve in 2007 in this recent survey. (It should be noted that a score of more than 50 points signals an expanding economy, while a score of less than 50 points indicates a shrinking economy.) However, Jim Hebert, president of Hebert Research said that chances of a recession in the next two or three years are getting higher, based on historical trends.

In a regional and national economic outlook prepared by the Puget Sound Business Journal and enterpriseSeattle, a mild global slowdown that's forecasted could help the local economy by reducing price pressures on energy and raw materials. This, along with the decline of the dollar relative to major trading partners, could provide positive growth for local exports. Regional economist Dick Conway sees the global conditions supporting a 9 percent growth in exports from our state, which would add 0.5 percent to Puget Sound's growth rate.

Local **development-activity** through March 2006 and 2007 as measured by the valuation of City of Kirkland building permits is illustrated in the chart to the right. Activity remains relatively strong, especially in the commercial sector. While single family activity in 2007 falls below 2006 levels, it still remains very strong compared to normal historical trends. Plan check fees (a leading indicator of development activity) are up in 2007 compared to the same period in 2006, so an upswing in building permit activity should follow.

In regard to **housing prices and sales**, the region seems to be escaping the major slow-down experienced elsewhere in the country. With warmer temperatures, the residential real estate market is heating up around Western Washington, according to the recent report from Northwest Multiple Listing Service. Eastside housing prices are up 9.6 percent and sales are up 1.5 percent comparing March 2007 to March 2006.

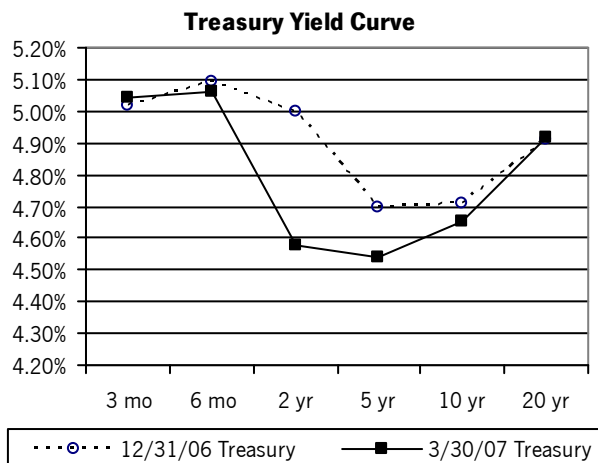
Seattle metro CPI continues to track higher than the national average (3.9 percent compared to 2.2 percent as of February).



Investment Report

MARKET OVERVIEW

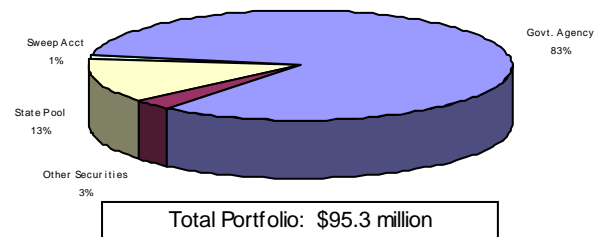
Fed Funds rate remained at 5.25 percent during the first quarter of 2007. The yield curve dropped in the one to ten year range while short term and long term rates remained fairly stable. Following the end of the first quarter the yield curve has risen and flattened as economic indicators have been mixed.



Diversification

The City's current investment portfolio is composed of Government Agency bonds, State and Local Government bonds, US Treasury notes, the State Investment Pool and an overnight bank sweep account. City investment procedures allow for 100% of the portfolio to be invested in US Treasury or Federal Government obligations.

Investments by Category



CITY PORTFOLIO

It is the policy of the City of Kirkland to invest public funds in a manner which provides the highest investment return with maximum security while meeting the City's daily cash flow requirements and conforming to all Washington state statutes governing the investment of public funds.

The primary objectives for the City of Kirkland's investment activities are: legality, safety, liquidity and yield. Additionally, the City diversifies its investments according to established maximum allowable exposure limits so that reliance on any one issuer will not place an undue financial burden on the City. The City's portfolio decreased slightly in the 1st quarter of 2007 to 95.3 million compared to \$97.9 million on December 31, 2006.

2007 ECONOMIC OUTLOOK and INVESTMENT STRATEGY

The forecast for the U.S. economy has not changed significantly during the first quarter. GDP growth for 2007 is expected to be 2.6 percent and GDP inflation at 2.3 percent. Beyond the very short term, the forecasters see little threat of accelerating inflation. CPI inflation is projected at 2.6 percent in 2007. The Fed Funds rate is expected to remain at 5.25 percent through the third quarter of 2007 with possible movements downward later in the year depending on the economy.

Investments beyond 2 and 3 years will be purchased as opportunities are available to obtain a return above the State Pool which is currently near 5.2 percent. We will continue to watch the economy closely and lengthen the duration as interest rates level off. Total budgeted investment income for 2007 is \$4 million

Investment Report *continued*

Liquidity

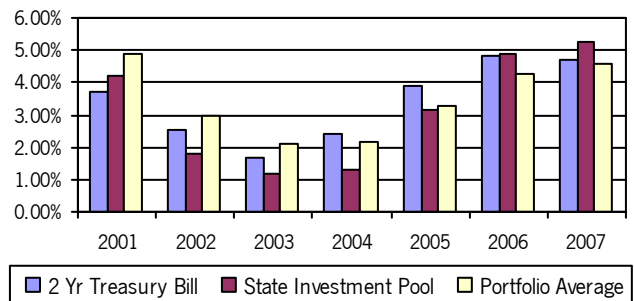
The target duration for the City's portfolio is based on the 2 year treasury rate which decreased from 4.82 percent on December 31, 2006 to 4.58 percent on March 31, 2007. The average maturity of the City's investment portfolio increased from .99 years on December 31, 2006 to 1.32 years on March 31, 2007.

Yield

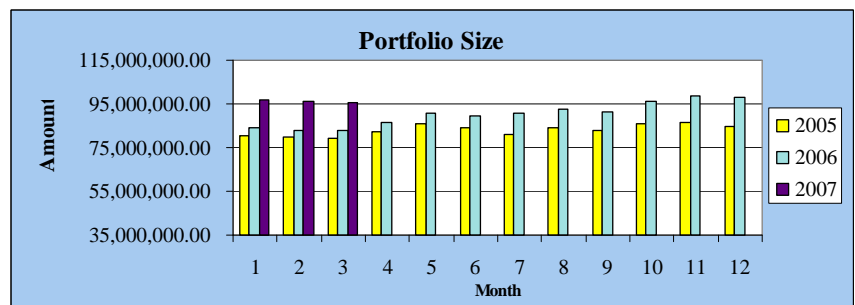
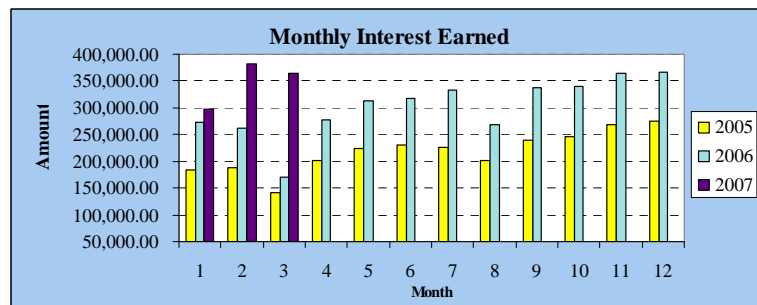
The City Portfolio yield to maturity increased from 4.51 percent on December 31, 2006 to 4.56 percent on March 31, 2007. Through March 31, 2007, the City's annual average yield to maturity was 4.56 percent, which performed under the State Investment Pool annual average yield to maturity at 5.24 percent and was below the 2 Year Treasury note annual average for 2007 at 4.72 percent.

Benchmark Comparison	31-Dec-06	31-Mar-07
City Yield to Maturity (YTM)	4.51%	4.56%
City Average YTM	4.25%	4.56%
City Year to Date Yield	3.99%	3.99%
State Pool Average Yield	4.90%	5.24%
2 yr Treasury Note Avg YTM	4.81%	4.72%

Investment Interest Rate Comparisons



The City's practice of investing further out on the yield curve than the State Investment Pool results in earnings higher than the State Pool during declining interest rates and lower earnings than the State Pool during periods of rising interest rates. This can be seen in the adjacent graph.



Reserve Summary

General Operating Reserve

For the City's "Rainy Day" fund, the target is established by fiscal policy at five percent of the operating budget (excluding utility and internal service funds). Each year, the target amount will change proportional to the change in the operating budget. To maintain full funding, the increment between five percent of the previous year's budget and the current budget would be added or subtracted utilizing interest income and year-end transfers from the General Fund. It is a reserve to be used for unforeseen revenue losses and other temporary events. If the reserve is utilized by the City Council, the authorization should be accompanied by a plan for replenishing the reserve within a two to three year period.

Revenue Stabilization Reserve

The Revenue Stabilization Reserve was approved by Council in July 2003 and was created by segregating a portion of the General Operating Reserve. The purpose of this reserve is to provide an easy mechanism to tap reserves to address temporary revenue shortfalls resulting from temporary circumstances (e.g. economic cycles, weather-related fluctuations in revenue). Council set the target at ten percent of selected General Fund revenue sources which are subject to volatility (e.g. sales tax, development fees and utility taxes). The Revenue Stabilization Reserve may be used in its entirety; however, replenishing the reserve will constitute the first priority for use of year-end transfers from the General Fund.

Contingency Fund

The Contingency Fund was established pursuant to RCW 35A.33.145 to "provide monies with which to meet any municipal expense, the necessity or extent of which could not have been foreseen or reasonably evaluated at the time of adopting the annual budget." State law sets the maximum balance in the fund at \$.375 per \$1,000 of assessed valuation. This reserve would be used to address unforeseen expenditures (as opposed to revenue shortfalls addressed by the Revenue Stabilization Reserve). The fund can be replenished through interest earnings up to the maximum balance or through the year-end transfer if needed. project).

Reserves are an important indicator of the City's fiscal health. They effectively represent "savings accounts" that are established to meet unforeseen budgetary needs (general purpose reserves) or are otherwise dedicated to a specific purpose (special purpose reserves). The City's reserves are listed with their revised estimated balances at the end of the biennium in the table below:

Reserves	2007-08 Est End Balance	2007 Auth. Uses	2007 Auth. Additions	Revised 2007-08 End Balance
GENERAL PURPOSE RESERVES				
Contingency	3,193,826	31,500		3,162,326
General Capital Contingency	3,312,834			3,312,834
Park & Municipal Reserve:				
General Oper. Reserve (Rainy Day)	2,712,836			2,712,836
Revenue Stabilization Reserve	2,082,380			2,082,380
Building & Property Reserve	1,316,124	10,000		1,306,124
Council Special Projects Reserve	309,960	15,000		294,960
Total General Purpose Reserves	12,927,960	56,500	0	12,871,460
SPECIAL PURPOSE RESERVES				
Excise Tax Capital Improvement:				
REET 1	6,673,678	598,194		6,075,484
REET 2	6,067,898			6,067,898
Equipment Rental:				
Vehicle Reserve	5,907,138			5,907,138
Radio Reserve	36,000			36,000
Information Technology:				
PC Replacement Reserve	453,670			453,670
Major Systems Replacement Reserve	666,500			666,500
Facilities Maintenance:				
Operating Reserve	550,000			550,000
Facilities Sinking Fund	1,439,951			1,439,951
Impact Fees				
Roads	1,984,145			1,984,145
Parks	920,086			920,086
Park Bond Reserve	502,916			502,916
Cemetery Improvement	476,401			476,401
Off-Street Parking	29,564			29,564
Tour Dock	73,211			73,211
Street Improvement	1,121,498	161,100		960,398
Firefighter's Pension	1,359,860			1,359,860
Park & Municipal Reserve:				
Litigation Reserve	20,004			20,004
Labor Relations Reserve	51,255			51,255
Police Equipment Reserve	26,519			26,519
LEOFF 1 Police Reserve	625,754			625,754
Facilities Expansion Reserve	800,000			800,000
Development Services Reserve	1,290,831			1,290,831
Tree Ordinance	13,750			13,750
Donation Accounts	143,859			143,859
Revolving Accounts	148,606			148,606
Water/Sewer Operating Reserve	1,511,245			1,511,245
Water/Sewer Debt Service Reserve	820,155			820,155
Water/Sewer Capital Contingency	1,703,640	113,900		1,589,740
Water/Sewer Construction Reserve	8,738,358	350,000		8,388,358
Surface Water Operating Reserve	320,299			320,299
Surface Water Capital Contingency	876,760	202,000		674,760
Surface Water-Transp. Related Rsv	1,417,365			1,417,365
Surface Water Construction Reserve	1,240,563			1,240,563
Total Special Purpose Reserves	48,011,479	1,425,194	0	46,586,285

Reserve Summary *continued*

RESERVE	AMOUNT	DESCRIPTION
2007 Council Authorized Uses		
Contingency Fund	\$31,500	Funding for phase 1 of the Permit Process Improvement Project to review the single family building permit process.
Building/Property Reserve	\$10,000	Funding for a study of the Peter Kirk Restroom to coincide with the timing of the design for the downtown transit center.
Council Special Projects Reserve	\$15,000	Funding for the Assistance League of the Eastside's Operation School Bell program.
Real Estate Excise Tax (REET) 1 Reserve	\$235,840	Funding for the purchase of the Irvin Property in the Yarrow Bay Wetlands.
	\$362,354	Funding for purchase of greenbelt property near Everest Park.
Street Improvement Reserve	\$91,100	Additional funding for completion of the Central Way Improvements project (street portion).
	\$70,000	Additional funding for the 2007 Pavement Striping Program.
Water/Sewer Capital Contingency	\$113,900	Additional funding for completion of the Central Way Improvements project (utilities portion).
Water/Sewer Construction Reserve	\$350,000	Additional funding to complete the 2007 Emergency Sewer Program.
Surface Water Capital Contingency	\$202,000	Additional funding for the Juanita Creek Channel Enhancement project.

2007 Council Authorized Additions

No Council Authorized Additions as of March 31, 2007.

Reserves	Revised 2007-08 End Balance	2007-08 Target	Over (Under) Target
GENERAL PURPOSE RESERVES			
Contingency	3,162,326	3,698,455	(536,129)
General Capital Contingency	3,312,834	5,822,280	(2,509,446)
Park & Municipal Reserve:			
General Oper. Reserve (Rainy Day)	2,712,836	3,134,779	(421,943)
Revenue Stabilization Reserve	2,082,380	2,143,422	(61,042)
Council Special Projects Reserve	294,960	250,000	44,960
Total General Purpose Reserves	11,565,336	15,048,936	(3,483,600)
SPECIAL PURPOSE RESERVES			
Excise Tax Capital Improvement:			
REET 1	6,075,484	1,435,000	4,640,484
REET 2	6,067,898	4,959,200	1,108,698
Information Technology:			
Major Systems Replacement Reserve	666,500	1,025,000	(358,500)
Firefighter's Pension	1,359,860	1,103,000	256,860
Park & Municipal Reserve:			
Litigation Reserve	20,004	50,000	(29,996)
LEOFF 1 Police Reserve	625,754	855,000	(229,246)
Development Services Reserve	1,290,831	1,290,831	0
Water/Sewer Operating Reserve	1,511,245	1,511,245	0
Water/Sewer Debt Service Reserve	820,155	820,155	0
Water/Sewer Capital Contingency	1,589,740	1,703,640	(113,900)
Surface Water Operating Reserve	320,299	320,299	0
Surface Water Capital Contingency	674,760	876,760	(202,000)
Total Special Purpose Reserves	21,022,530	15,950,130	5,072,400

The summary schedule in the table above details all Council authorized uses and additions to each reserve through March 2007.

The table to the left compares the revised ending balance to the targets established in the budget process.



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- ◆ Tracey Dunlap, Director of Finance & Administration
- ◆ Sandi Hines, Financial Planning Manager
- ◆ Michael Olson, Treasury Manager
- ◆ Teresa Levine, Interim Financial Operations Manager
- ◆ Sri Krishnan, Senior Financial Analyst
- ◆ Neil Kruse, Budget Analyst

www.ci.kirkland.wa.us

The **Financial Management Report (FMR)** is a high-level status report on the City's financial condition that is produced quarterly.

- It provides a summary **budget to actual** comparison for year-to-date revenues and expenditures for all operating funds. The report also compares this year's actual revenue and expenditure performance to the prior year.
- The **Sales Tax Revenue Analysis Report** takes a closer look at the City's largest and most economically sensitive revenue source.
- **Economic environment** information provides a brief outlook at the key economic indicators for the Eastside and Kirkland such as office vacancies, residential housing prices/sales, development activity, inflation and unemployment.
- The **Investment Summary** report includes a brief market overview, a snapshot of the City's investment portfolio, and the City's year-to-date investment performance.
- The **Reserve Summary** report highlights the uses of and additions to the City's reserves in the current year as well as the projected ending reserve balance relative to each reserve's target amount.

Economic Environment Update References:

- Glen Pascall, *Finding good news as economy throttles back*, Puget Sound Business Journal, January 19, 2007
- Jeff Meisner, *Executives bullish over the near-term economy*, Puget Sound Business Journal, May 18, 2007
- CB Richard Ellis Real Estate Services, Market View Puget Sound, First Quarter 2007
- Northwest Multiple Listing Service
- Washington State Economic and Revenue Forecast Council
- City of Kirkland Building Division
- City of Kirkland Finance Department